Australian
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Commission

IMPUTATION TESTING AND NON-PRICE TERMS AND CONDITIONS REPORT RELATING TO THE ACCOUNTING SEPARATION OF TELSTRA FOR THE DECEMBER QUARTER 2004

March 2005

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Summary

This report contains the December quarter 2004 imputation testing and non-price terms and conditions results prepared under the enhanced accounting separation regime for Telstra.

This is the sixth round of reporting produced in accordance with a Direction issued by the Minister for Communications, Information Technology and the Arts on 19 June 2003.

The report is intended to provide greater transparency of Telstra's operations to ensure that it does not unfairly discriminate between its own retail operations and access seekers using its network.

Imputation testing

Imputation testing is designed to reveal whether there is a sufficient margin between Telstra's retail prices and the prices it charges access seekers to use its network (plus related costs) to enable access seekers to compete in retail telecommunications markets.

Imputation testing has been undertaken for the following retail services for, firstly, residential customers, and secondly, business customers:

- local calls and line rental
- domestic long-distance calls
- international long-distance calls
- fixed-to-mobile calls
- asymmetric digital subscriber line (ADSL) services.

Separate tests are conducted using historical and current costs. The results indicate that Telstra passes the imputation tests for domestic and international long-distance calls, fixed-to-mobile calls, and across the bundle of fixed voice telephony services. However, Telstra fails the imputation test for local call services (line rental and local calls combined) and all ADSL tests.

Telstra again fails the ADSL tests by significant margins. The results appear to indicate that the costs of transforming the ULLS into ADSL, and not the access price for the ULLS core service, is the main reason for the fail results. However the ACCC cautions that the results should be carefully interpreted before any assessment of their implications for access seekers is made.

The ACCC notes that there may be some methodological issues that require further attention to ensure that the tests are properly conducted. Also, it should be noted that the tests are conducted on a fully allocated cost basis and on the premise that an access seeker is no more efficient than Telstra.

KPIs for non-price terms and conditions

The key performance indicators on non-price terms and conditions measure the difference between the percentage of Telstra Wholesale's customers and Telstra Retail's customers (for business and residential customer groups separately) for which performance standards are met

(defined according to the Customer Service Guarantee measures). Key performance indicators currently cover the supply of the basic access service, including:

- ordering and provisioning
- faults and maintenance
- appointments.

Telstra's results indicate, consistent with previous quarters, that there does not appear to be any systematic discrimination against Telstra Wholesale's customers. However, as the results are highly aggregated they do not provide a means of identifying or addressing individual cases of discrimination. The ACCC will continue to respond to complaints of discrimination on their merits.

Accuracy

As the reports for the December quarter 2004 have not been audited, the ACCC cannot vouch for their accuracy at this stage.

1 Introduction

On 19 June 2003, the Minister for Communications, Information Technology and the Arts directed the ACCC to use its record keeping rule (RKR) making powers under the *Trade Practices Act 1974* (the Act) to introduce enhanced accounting separation of Telstra.

In accordance with this Direction, the ACCC issued RKRs requiring Telstra to provide the ACCC with reports on:

- regulatory accounting statements that have been prepared on a current cost basis, in addition to reports prepared on a historical cost basis, under the Telecommunications Industry Regulatory Accounting Framework for core services (CCA reports)

- imputation analysis comparing Telstra's retail prices and the costs faced by access seekers in purchasing core services from Telstra to supply competing retail services (imputation reports)

- key performance indicators on non-price terms and conditions that compare Telstra's customer service performance between specified retail and wholesale supplied services (NPTC reports).

The Direction also requires that the ACCC publish the reports and a commentary which discusses:

- the accuracy of the reports

- the extent to which the reports comply with:

  — the Regulatory Accounting Framework (for the imputation report only)

  — any other relevant record-keeping rules made by the ACCC

  — any Direction given by the ACCC for Telstra to make public information contained in the reports.

The comments are to include any qualifications that the ACCC considers necessary.

For the imputation report, the ACCC must also summarise the results of the imputation analysis.

Telstra's CCA reports are submitted separately from this report. The Direction also requires the ACCC to provide a six-monthly report on competition in the corporate customer segment of the telecommunications market. This report is also produced separately.

Purpose of the reports

The Government's purpose in establishing the enhanced accounting separation framework for Telstra is to provide the ACCC, access seekers and the public with greater transparency about Telstra's wholesale and retail costs.[1]

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[1] DCITA, *Draft Direction on Telstra's accounting separation issued for public comment*, media release, 19 March 2003.

For example, it is intended to assist the ACCC in investigating conduct that may breach Part IV and Part XIB of the Act. This would include conduct such as predatory pricing, retail margin squeezing, cross-subsidisation and vertical cost shifting[2]. In such investigations it is usually important to be able to carefully distinguish between wholesale and retail costs.

Given that the ACCC remains concerned about Telstra's market power and its degree of horizontal and vertical integration, it supports measures such as the enhanced accounting separation regime that are aimed at increasing the level of transparency available to regulators, competitors and the general public.

However the ACCC considers that the enhanced accounting separation regime should be kept under review. This will ensure that it is appropriately targeted and that the anticipated benefits of enhanced accounting separation are realised. A formal consultative group, the Accounting Separation Consultative Committee (ASCC), has been established by the ACCC. The ASCC enables the ACCC to provide information to industry and receive feedback from industry about regime. The ASCC comprises the ACCC, Telstra and other industry and user representatives. The ASCC met on 14 May 2004 and 7 December 2004, and intends to continue to meet every six months.

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2 See ACCC, *Current cost methodology for Telstra's subsequent reports under the accounting separation regime, framework document*, January 2004, p. 8-9.

2 Imputation report

2.1 Introduction to the imputation RKR

This section presents the imputation analysis of core telecommunications services supplied to access seekers. Results from previous quarters have been included to enable comparison.

On 26 June 2003 the ACCC issued an imputation RKR to Telstra. The RKR was revised on 1 September 2003 mainly as a result of Telstra advising that it could not comply with certain aspects of the rule due to data constraints. Reports provided under that rule are referred to as the initial reports.

On 29 September 2004, the ACCC issued a revised imputation RKR. Reports provided under this revised rule, which applies from the September quarter 2004 onwards, are referred to as subsequent reports.

The primary objective of the imputation RKR is to provide an indication of whether Telstra is engaging in systemic price squeeze behaviour in relation to core telecommunications services.[3]

Whether Telstra fails or passes the imputation tests does not determine whether or not Telstra has contravened the Act. Further evidence of the purpose or effect of the specific conduct is required, in addition to the other requirements of the Act. For example, a contravention of the Act would require consideration of the appropriate market definition, which may not be the same as the service descriptions used in the imputation RKR.[4]

The Direction requires that the imputation tests be made public to improve transparency about potential price squeezes for core telecommunications services.

2.2 Background

2.2.1 Vertical price squeezing

Telstra is a vertically integrated carrier that owns the delivery platform over which its services are supplied. It supplies retail telecommunications services, such as local calls, to end users and also supplies wholesale access services to competing retail suppliers. For many telephony services, Telstra's retail competitors rely on wholesale supply from Telstra, such as access to the 'local loop' (specifically, PSTN origination and termination). The competitors then add network services (e.g. long-distance transmission for long-distance calls) and retail services (e.g. billing or call centre support).

A 'price squeeze' could occur if Telstra reduces the margin between its retail price and the wholesale access price it charges for an essential input to that retail service. Telstra could reduce

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3 Senator Alston, *Government boost to telecommunications competition*, media release, 24 September 2002.

4 For further discussion on imputation testing, refer: ACCC, *Bundling in telecommunications market—an ACCC information paper*, August 2003.

the margin by lowering the retail price for the service and/or raising the wholesale access price for the essential input.

If the difference between the wholesale access price and the retail price is not sufficient to cover Telstra's network and retail costs of supply, retail suppliers as efficient as Telstra in the supply of the retail service might not be able to remain in the market, as they would be achieving negative margins.

Imputation testing can be used to detect possible price squeezes in a retail market.

2.2.2 What are the elements of an imputation test?

An imputation test compares:

- the retail price charged by Telstra for a particular service
- the wholesale access price charged by Telstra for access to its network plus the additional costs incurred in transforming the essential input to the retail service.

Where the retail price is less than the sum of the wholesale access price and additional costs, a price squeeze is said to exist.

2.3 The imputation tests in this RKR

In this report, imputation testing is conducted on the following retail services that use Telstra's core telecommunications services as inputs:

- local calls and line rental, which use the local carriage service (LCS)
- domestic long-distance calls, which use the PSTN originating and terminating access services (PSTN O/T)
- outgoing international long-distance calls, which use the PSTN originating access service (PSTN O)
- fixed-to-mobile calls, which use the PSTN O
- asymmetric digital subscriber line (ADSL) services, which use the unconditioned local loop service (ULLS).

There are three main variables in an imputation test: the retail price of the retail service; the access price for the core service and the additional costs of transforming the core service into the retail service. The imputation RKR details how each variable is calculated. The results are presented in tables 2.1 – 2.4.

- The 'retail price' is the average retail price of each retail service. This is calculated by using the total revenue and volume data provided by Telstra.
- The 'access price' is the volume weighted average of the prices that Telstra charges its access seekers for the service.

- The ‘unit cost’ is the average total cost of transforming the core input into the relevant retail service. The costs of transforming the essential input are reported in two categories: ‘retail costs’ and ‘other costs’.
    - Costs are derived from the Telecommunications Industry Regulatory Accounting Framework (RAF), which allocates direct and common costs. The costs attributed to ‘retail services’ in the RAF provide the ‘retail costs’ for the imputation tests. However, there are further costs incurred in transforming a core service to a retail service, such as transmission. These are listed as ‘other costs’ in the imputation results. The tests also separate out the cost of capital and ancillary charges.
    - The sum of the ‘retail costs’, ‘other costs’, ancillary charges and cost of capital, per unit of retail service, is the ‘unit cost’.
    - The imputation RKR requires Telstra to provide costs calculated on both a historical cost basis and current cost accounting basis.
    - The ACCC and Telstra have agreed to certain procedures for addressing methodological issues about costs, as outlined in section 2.7.

The imputed margin for each retail service can then be calculated:

- The ‘imputed margin’ is calculated by subtracting the ‘access price’ and ‘unit cost’ from the ‘retail price’ for each retail service. This represents the margin that could be available to competitors, who are equally efficient as Telstra, if supplying the retail service using Telstra’s core service.[5]
- The imputation margin as a percentage of retail price is also included in the imputation tables.

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[5] As noted above, this margin is calculated after a contribution is made to ‘common costs’—that is, costs that are shared between multiple services.

2.4 Results submitted by Telstra

Table 2.1 Imputation report for December quarter 2004 on a historical cost basis

	Local carriage service		Domestic PSTN originating and terminating access services		Domestic PSTN originating access service				Total Bundle of Fixed Voice Products		
	Local calls and Line rental		Domestic long distance		International long distance		Fixed to mobile		Bundle		
	Business	Residential	Business	Residential	Business	Residential	Business	Residential	Business	Residential	Total
Revenues											
retail	319,713,571	594,933,195	66,410,049	192,896,136	11,258,036	51,294,084	114,656,007	214,887,387	512,037,664	1,054,010,802	1,566,048,465
other	0	0	0	0	0	0	0	0	0	0	0
total	319,713,571	594,933,195	66,410,049	192,896,136	11,258,036	51,294,084	114,656,007	214,887,387	512,037,664	1,054,010,802	1,566,048,465
Retail Costs											
organisation	33,430,341	75,641,400	3,047,824	10,597,014	615,106	3,540,053	4,675,599	6,819,317	41,768,870	96,597,784	138,366,654
product and consumer	21,316,965	47,274,099	3,503,803	12,182,416	3,831,137	22,048,927	77,153,371	112,527,451	105,805,277	194,032,894	299,838,170
total	54,747,306	122,915,499	6,551,627	22,779,430	4,446,244	25,588,980	81,828,970	119,346,768	147,574,146	290,630,677	438,204,824
Other Costs											
organisation	0	0	142,726	496,246	27,419	157,804	237,414	346,266	407,559	1,000,315	1,407,875
product and consumer	0	0	15,486	53,843	4,295	24,721	29,813	43,483	49,595	122,046	171,641
network expenses	0	0	937,169	3,258,456	191,968	1,104,812	1,339,494	1,953,639	2,468,631	6,316,906	8,785,538
total	0	0	1,095,381	3,808,544	223,683	1,287,336	1,606,721	2,343,387	2,925,785	7,439,268	10,365,053
Ancillary*	N/A	N/A	297,003	1,032,653	7,690	44,255	116,038	169,240	420,731	1,246,148	1,666,879
Cost of Capital	12,728,579	28,155,730	3,092,011	10,750,651	593,615	3,416,367	6,020,530	8,780,885	22,434,735	51,103,633	73,538,368
Retail Volumes**	2,526,257	5,820,040	431,978,009	1,501,949,533	22,368,436	128,734,620	337,544,876	492,305,963			
Retail price	126.5563	102.2215	0.1537	0.1284	0.5033	0.3984	0.3397	0.4365	202.6863	181.1003	187.6339
Access price	118.6742	94.9560	0.0220	0.0180	0.0104	0.0091	0.0134	0.0125	124.3233	100.8616	107.9630
Unit cost	26.7098	25.9571	0.0255	0.0255	0.2357	0.2357	0.2654	0.2654	68.6215	60.2092	62.7554
Imputed margin	-18.8278	-18.6915	0.1061	0.0849	0.2572	0.1537	0.0609	0.1586	9.7416	20.0295	16.9155
Imputed margin %	-14.8770%	-18.2853%	69.0469%	66.0868%	51.1119%	38.5711%	17.9365%	36.3420%	4.8062%	11.0599%	9.0152%

Table 2.2 ULLS report for December quarter 2004 on a historical cost basis

	Unconditioned Local Loop Service			
	ADSL Service		ADSL, local calls, line rental, domestic long distance, international and FTM	
	Business	Residential	Business - 1 x ADSL Service + 4 x Voice Lines	Residential -1 x ADSL Service +1 x Voice Line
Revenues				
retail	14,475,386	41,133,221	85,136,024	93,106,157
other	0	0	0	0
total	14,475,386	41,133,221	85,136,024	93,106,157
Retail Costs				
organisation	7,526,280	24,782,519	13,315,526	29,529,092
product and consumer	11,496,934	37,857,078	26,513,570	47,150,321
total	19,023,214	62,639,596	39,829,096	76,679,413
Other Costs				
organisation	1,877,495	6,182,212	5,578,922	9,286,079
product and consumer	996,995	3,282,902	1,536,591	3,838,385
network expenses	5,731,005	18,871,042	16,579,449	28,485,530
total	8,605,495	28,336,156	23,694,963	41,609,993
Ancillary Charges (TEBA)*	1,262,618	4,157,546	1,277,290	4,218,581
Cost of Capital	5,383,484	17,726,723	19,087,260	29,241,356
Retail Volume**	87,155	286,984	87,155	286,984
Retail price	166.0875	143.3291	976.8328	324.4294
Access price	71.6353	71.6353	137.7079	98.4093
Unit cost	393.2620	393.2620	962.5202	528.7722
Imputed margin	-298.8097	-321.5681	-123.3953	-302.7521
Imputed margin %	-179.9110%	-224.3564%	-12.6322%	-93.3183%

Table 2.3 Imputation report for December quarter 2004 on a current cost basis

	Local carriage service		Domestic PSTN originating and terminating access services		Domestic PSTN originating access service				Total Bundle of Fixed Voice Products		
	Local calls and Line rental		Domestic long distance		International long distance		Fixed to mobile		Bundle		
	Business	Residential	Business	Residential	Business	Residential	Business	Residential	Business	Residential	Total
Revenues											
retail	319,713,571	594,933,195	66,410,049	192,896,136	11,258,036	51,294,084	114,656,007	214,887,387	512,037,664	1,054,010,802	1,566,048,465
other	0	0	0	0	0	0	0	0	0	0	0
total	319,713,571	594,933,195	66,410,049	192,896,136	11,258,036	51,294,084	114,656,007	214,887,387	512,037,664	1,054,010,802	1,566,048,465
Retail Costs											
organisation	33,438,291	75,659,430	3,048,455	10,599,210	615,239	3,540,819	4,676,595	6,820,769	41,778,580	96,620,228	138,398,808
product and consumer	21,317,474	47,275,251	3,503,847	12,182,568	3,831,146	22,048,980	77,153,441	112,527,553	105,805,908	194,034,351	299,840,259
total	54,755,764	122,934,681	6,552,302	22,781,777	4,446,386	25,589,799	81,830,036	119,348,323	147,584,488	290,654,580	438,239,068
Other Costs											
organisation	0	0	118,950	413,580	24,571	141,413	8,128	11,855	151,650	566,848	718,498
product and consumer	0	0	14,935	51,929	4,230	24,342	1,260	1,837	20,425	78,108	98,533
network expenses	0	0	937,169	3,258,455	191,968	1,104,811	41,342	60,297	1,170,479	4,423,563	5,594,042
total	0	0	1,071,055	3,723,964	220,769	1,270,566	50,730	73,989	1,342,553	5,068,519	6,411,073
Ancillary*	N/A	N/A	297,003	1,032,653	7,690	44,255	116,038	169,240	420,731	1,246,148	1,666,879
Cost of Capital	12,729,903	28,158,728	3,347,952	11,640,533	635,515	3,657,513	6,340,605	9,247,712	23,053,976	52,704,486	75,758,461
Retail Volumes**	2,526,257	5,820,040	431,978,009	1,501,949,533	22,368,436	128,734,620	337,544,876	492,305,963			
Retail price	126.5563	102.2215	0.1537	0.1284	0.5033	0.3984	0.3397	0.4365	202.6863	181.1003	187.6339
Access price	118.6742	94.9560	0.0220	0.0180	0.0104	0.0091	0.0134	0.0125	124.3233	100.8616	107.9630
Unit cost	26.7137	25.9609	0.0261	0.0261	0.2374	0.2374	0.2617	0.2617	68.2440	60.0810	62.5517
Imputed margin	-18.8317	-18.6953	0.1056	0.0843	0.2555	0.1519	0.0646	0.1623	10.1191	20.1577	17.1192
Imputed margin %	-14.8801%	-18.2891%	68.6972%	65.6681%	50.7644%	38.1320%	19.0135%	37.1801%	4.9925%	11.1307%	9.1237%

Table 2.4 ULLS tests for December quarter 2004 on a current cost basis

	Unconditioned Local Loop Service			
	ADSL Service		ADSL, local calls, line rental, domestic long distance, international and FTM	
	Business	Residential	Business - 1 x ADSL Service + 4 x Voice Lines	Residential - 1 x ADSL Service +1 x Voice Line
Revenues				
retail	14,475,386	41,133,221	85,136,024	93,106,157
other	0	0	0	0
total	14,475,386	41,133,221	85,136,024	93,106,157
Retail Costs				
organisation	7,528,528	24,789,921	13,319,119	29,537,598
product and consumer	11,497,078	37,857,552	26,513,802	47,150,867
total	19,025,606	62,647,474	39,832,921	76,688,465
Other Costs				
organisation	1,951,922	6,427,284	5,771,033	9,594,530
product and consumer	998,729	3,288,614	1,541,071	3,845,582
network expenses	5,731,007	18,871,048	16,579,455	28,485,538
total	8,681,659	28,586,946	23,891,559	41,925,649
Ancillary Charges (TEBA)*	1,262,618	4,157,546	1,277,290	4,218,581
Cost of Capital	4,586,039	15,100,898	24,429,250	31,656,161
Retail Volume**	87,155	286,984	87,155	286,984
Retail price	166.0875	143.3291	976.8328	324.4294
Access price	71.6353	71.6353	137.7079	98.4093
Unit cost	385.0136	385.0136	1026.1127	538.3181
Imputed margin	-290.5613	-313.3197	-186.9877	-312.2979
Imputed margin %	-174.9447%	-218.6015%	-19.1422%	-96.2607%

Table 2.5 Telstra's revised ULLS tests for September quarter 2004 on a historical cost basis

	Unconditioned Local Loop Service			
	ADSL Service		ADSL, local calls, line rental, domestic long distance, international and FTM	
	Business	Residential	Business - 1 x ADSL Service + 4 x Voice Lines	Residential - 1 x ADSL Service +1 x Voice Line
Revenues				
retail	12,091,080	32,894,152	73,279,056	72,448,787
other	0	0	0	0
total	12,091,080	32,894,152	73,279,056	72,448,787
Retail Costs				
organisation	6,381,645	19,086,934	11,365,214	22,726,475
product and consumer	9,748,422	29,156,664	22,577,787	36,219,358
total	16,130,067	48,243,598	33,943,001	58,945,833
Other Costs				
organisation	1,591,956	4,761,400	4,751,813	7,167,831
product and consumer	845,367	2,528,417	1,304,741	2,957,458
network expenses	4,859,405	14,534,049	14,198,853	22,043,333
total	7,296,728	21,823,866	20,255,407	32,168,622
Ancillary Charges (TEBA)*	1,104,220	3,302,625	1,104,220	3,302,625
Cost of Capital	4,564,736	13,652,721	16,322,842	22,560,577
Retail Volume**	73,900	221,029	73,900	221,029
Retail price	163.6137	148.8229	991.5953	327.7798
Access price	73.6900	73.6900	151.0824	103.9713
Unit cost	393.7170	393.7170	969.2194	529.2416
Imputed margin	-303.7933	-318.5841	-128.7064	-305.4331
Imputed margin %	-185.6772%	-214.0693%	-12.9797%	-93.1824%

Table 2.6 Telstra's revised ULLS tests for September quarter 2004 on a current cost basis

	Unconditioned Local Loop Service			
	ADSL Service		ADSL, local calls, line rental, domestic long distance, international and FTM	
	Business	Residential	Business - 1 x ADSL Service + 4 x Voice Lines	Residential - 1 x ADSL Service +1 x Voice Line
Revenues				
retail	12,091,080	32,894,152	73,279,056	72,448,787
other	0	0	0	0
total	12,091,080	32,894,152	73,279,056	72,448,787
Retail Costs				
organisation	6,383,552	19,092,636	11,368,276	22,733,022
product and consumer	9,748,544	29,157,029	22,577,985	36,219,779
total	16,132,095	48,249,665	33,946,261	58,952,801
Other Costs				
organisation	1,655,064	4,950,148	4,909,663	7,401,299
product and consumer	846,838	2,532,816	1,308,422	2,962,907
network expenses	4,859,407	14,534,054	14,198,858	22,043,339
total	7,361,308	22,017,018	20,416,943	32,407,545
Ancillary Charges (TEBA)*	1,104,220	3,302,625	1,104,220	3,302,625
Cost of Capital	3,888,571	11,630,370	20,848,805	24,412,777
Retail Volume**	73,900	221,029	73,900	221,029
Retail price	163.6137	148.8229	991.5953	327.7798
Access price	73.6900	73.6900	151.0824	103.9713
Unit cost	385.4686	385.4686	1032.6936	538.7340
Imputed margin	-295.5449	-310.3357	-192.1807	-314.9255
Imputed margin %	-180.6358%	-208.5269%	-19.3810%	-96.0784%

2.4.1 Notes to tables

Notes to Table 2.1 and Table 2.3 relating to fixed line telephony services:

* All retail volumes are reported in minutes with the exception of the local carriage service where volumes are in SIOs.

Notes to Table 2.2 and Table 2.4, and Telstra's revised September quarter 2004 tables (Table 2.5 and 2.6) relating to services supplied by the ULLS:

* As per instructions from the ACCC, ancillary charges are calculated as TEBA revenues per ULL service that are reasonably expected in a mature market. This is calculated as the TEBA revenue for the September/December quarter divided by the adjusted number of installed tie cable pairs. The adjustment factor set by the ACCC is 66 per cent.

** Retail volumes are reported in terms of SIOs.

2.5 Summary of results

2.5.1 Overview

There was little difference between the imputation results based on historical cost and those based on current cost. Current cost accounting adjusts historical cost data to allow for cost variations in depreciation and cost of capital to Telstra's fixed assets. However, as imputation tests use the access price instead of Telstra's actual cost of supplying the core service using its fixed assets, the current cost imputed margins are unlikely to significantly differ from historical cost margins.

While the ACCC has provided the imputation results for both historical and current cost, the ensuing discussion focuses on the historical cost results.

The imputation RKR uses average total cost in calculating the cost of transforming Telstra's core service into a retail service. The ACCC believes that this measure provides an important indicator of the long-run impacts of particular pricing.[6]

The ACCC considers that the principles on which the imputation tests are based are sound. Although some assumptions have been made to overcome data limitations—these are described below in section 2.7.3—Telstra and the ACCC have worked together to ensure that these issues are treated appropriately. As such, the ACCC considers that the results of the imputation tests are accurate.

However, the aggregated nature of the imputation tests means that they will not provide an accurate reflection of the actual commercial situation faced by all access seekers. Some access seekers will be competing for higher value customers, or operating in lower cost areas, whereas the tests are conducted on a fully averaged basis.

As such, certain refinements to the tests would aid in the interpretation of the results, although the costs and benefits of doing so would need to be considered. The ACCC intends to consider whether the following or similar initiatives should be implemented:

- conducting separate tests for different geographic areas—e.g., metropolitan areas
- conducting separate tests for larger business customers—e.g., corporate and government customers.

Table 2.7 provides an overview of the imputation test results. The results show that Telstra passes the imputation tests for domestic and international long-distance calls, fixed-to-mobile calls, and across the bundle of fixed voice products. However, Telstra fails for line rental and local calls, ADSL services and bundles containing ADSL and fixed voice products.

Comment on particular results is in sections 2.5.2 to 2.5.6.

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6 The ACCC has discussed this issue in its *Bundling in telecommunications markets* report, fn 4.

Table 2.7 Imputation testing undertaking on a historical cost basis

			Imputed margin (by quarter)						
Retail service	**Core service(s)**		**Sep 03***	**Dec 03**	**Mar 04**	**Jun 04**	**Sep 04**	**Dec 04**	**Result**
Local calls and line rental	LCS	Business	-9%	-10%	-16%	-17%	-18%	-15%	Fail
		Residential	-8%	-8%	-17%	-13%	-19%	-18%	Fail
Domestic long-distance	PSTN O/T	Business	64%	64%	65%	66%	69%	69%	Pass
		Residential	58%	59%	60%	61%	66%	66%	Pass
International long-distance	PSTN O	Business	40%	24%	49%	49%	48%	51%	Pass
		Residential	24%	22%	36%	37%	41%	39%	Pass
Fixed-to-mobile	PSTN O	Business	21%	19%	15%	14%	17%	18%	Pass
		Residential	36%	36%	32%	34%	36%	36%	Pass
Bundle of fixed voice services#	LCS & PSTN O/T	Business	11%	8%	5%	4%	3%	5%	Pass
		Residential	15%	15%	10%	12%	9%	11%	Pass
		Total	13%	13%	8%	9%	7%	9%	Pass
ADSL	ULLS	Business	-	-	-	-	-186%	-180%	Fail
		Residential	-	-	-	-	-214%	-224%	Fail
Bundle of ADSL and all fixed voice services	ULLS & PSTN T	Business^	-	-	-	-	-13%	-13%	Fail
		Residential	-	-	-	-	-93%**	-93%	Fail

* Telstra provided revised margins for the September 2003 quarter in May 2004.
** Telstra revised the margin for the residential bundle of ADSL and fixed line services from -85% to -93% in February 2005.
# The bundle of fixed voice services comprises of locals calls and line rental, domestic and international long-distance and fixed-to-mobile calls.
^ The bundle for business customers contains one ADSL service and four bundles of fixed voice services.

The results are broadly consistent with the results from previous quarters.

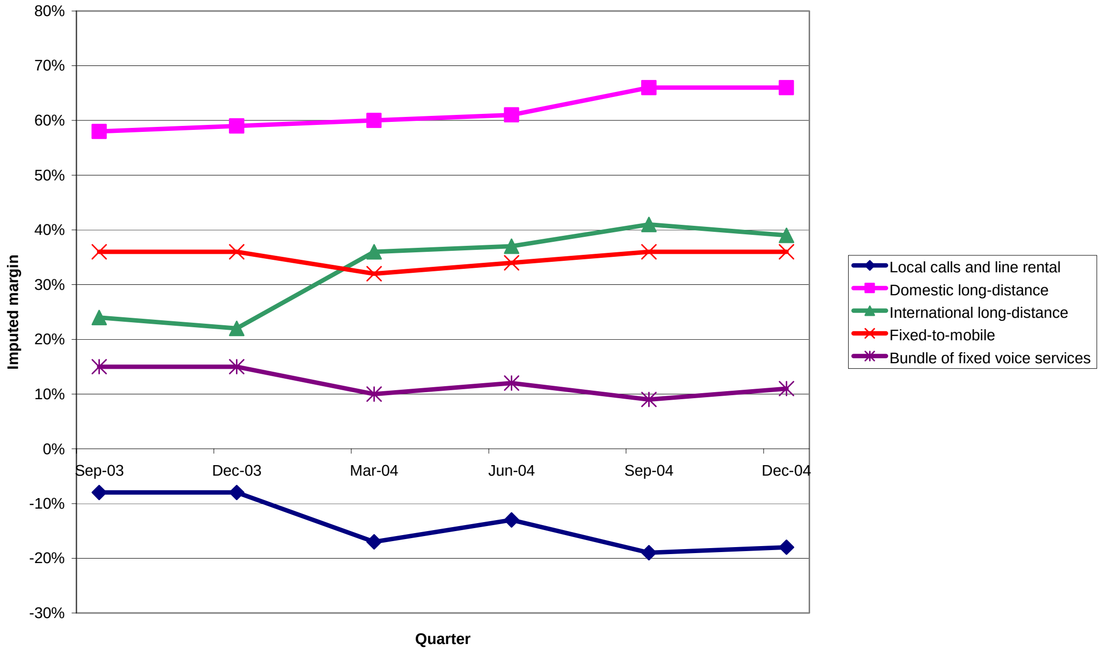
The noticeable margin changes from the previous quarter are for line rental and local calls, international long-distance calls and the ADSL service on its own. The reduced (i.e. more positive) fail margins for line rental and local calls appear to result from lower access prices. The margin for business international calls per minute has also increased by 3%. The reported drop in international call volumes, with revenues remaining fairly even, resulted in an increase in the average retail price per minute and, consequently, the overall margin.

Volumes for ADSL increased in the December quarter by 65 955 for residential customers (an increase of 30%) and 13 255 for business customers (an increase of 18%) from the September quarter. Revenues also increased between quarters: revenues for residential customers increased by 25% while revenues for business customers increased by 20%. As a result, the average retail price for residential ADSL services decreased between quarters while the average retail price for business customers increased. The changes in the average retail prices appear to be the main driver of the changes in the imputed margins for ADSL services between quarters.

However, the changes in ADSL volumes do not appear to have changed the imputed margins for the bundles of ADSL and voice services. This appears to be because the decreases in the average retail prices for the ADSL services are offset by the decrease in the access price for the fixed voice services (presumably driven by the fall in access price for line rental and local calls).

The ACCC now has six quarters of data which can be useful to show changes over time. Figure 2.1 graphs the imputed margins (by percentage) each quarter for residential voice services.

Figure 2.1 Residential imputation results



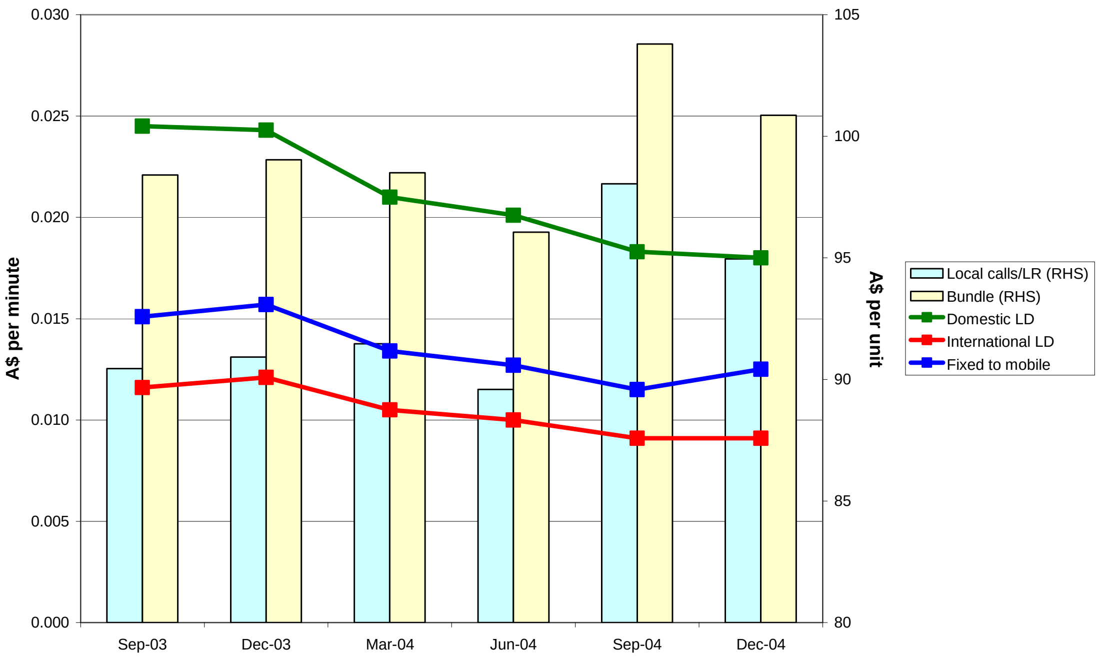
The above graph shows that the results for residential voice services have remained broadly consistent over time. Greater variations appear to occur in the data after every second quarter, coinciding with changes in the underlying RAF cost database.

For example, the imputed margin for international calls noticeably increased between the December 2003 and March 2004 quarters. This coincided with the change in the underlying half-yearly RAF used to obtain unit costs. The unit costs for the December quarter were calculated from the January–June 2003 RAF whereas the March 2004 quarter unit costs were based on the July–December 2003. At the time, Telstra explained that the decrease in the unit cost was due to a decrease in international settlement costs mostly driven by an appreciation in Australia’s exchange rate.

In addition to changes in the underlying cost database, changes in revenues and volumes for retail services impact on the resultant imputed margins.

Further, changes in the revenues and volumes that Telstra receives from access seekers for core services change the access price in the imputation tests. The access price is derived as the volume weighted average price. Changes in access prices for the retail services are shown in Figure 2.2 below.

Figure 2.2 Access prices for core services



Movements in the access prices can be observed over the six quarters. For example, the access price for domestic long-distance services, which uses the PSTN O/T, has decreased from 2.5 cents per minute in September 2003 to 1.8 cents per minute in December 2004. Greater variation in access prices appears to occur for services using the PSTN (the coefficient of variation is around 12–14% for those services) compared with the variation for services using the LCS (the coefficient of variation is around 4% for line rental and local calls).[7]

2.5.2 Line rental and local calls

The results indicate that Telstra would receive a negative margin if it supplied the grouped local call and line rental retail services by purchasing the LCS input at arms' length from itself. Telstra has achieved 'fails' for the local call and line rental services in all imputation reports.

These results could be seen as raising price squeeze concerns. However, failure of an imputation test does not necessarily show a contravention of the Act.

The ACCC does not regard the failures for the local call and line rental retail product as being a concern at this stage.

The first reason for this view is that positive margins on long-distance calls may mean that competing retail providers could recover the loss on line rental and local calls from their long-distance and fixed-to-mobile businesses. The positive margins on the bundles of line rental, local calls, long-distance and fixed-to-mobile calls tend to

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[7] The coefficient of variation is the standard deviation divided by the mean for the sample set, and provides a measure of variability that can be compared between data sets of different units.

support this proposition. The ACCC has previously noted in its *Final determination for model price terms and conditions for the PSTN, ULLS and LCS* that:

> The Commission's imputation analysis indicated that there is cross-subsidisation of Telstra's local call services [consisting of line rental, local and neighbourhood calls] from its long distance services. However, the existence of positive margins on the long distance services which more than offset the negative margins on local call services means that Telstra's retail local call prices are not considered predatory because access seekers should be able to emulate this cross-subsidisation.[8]

The ACCC understands that access seekers would aim to supply long-distance and fixed-to-mobile calls to customers in addition to providing local calls.

Secondly, the ACCC uses 'unbundled' local call retail prices in a 'retail minus' methodology to determine the access price for the LCS. Local call retail prices can be for local calls as part of a bundle of retail service offerings, or for stand-alone local calls (i.e. unbundled prices). These unbundled prices might be expected to be higher than the average retail prices used in the imputation test. This may make an imputation test failure for the local call and line rental retail service more likely.

That said, the ACCC will shortly release a discussion paper on its review of the LCS declaration and associated pricing principles. The ACCC will further consider Telstra's continued fail results for the combined local call and line rental product in light of information made available in the course of that inquiry.[9]

The ACCC also notes that the imputed margin for local calls and line rental for residential customers may be understated because of the inclusion of Telstra's 'InContact' product. This product can be used to receive calls and to make calls to a limited range of services including emergency numbers, service difficulties and faults. The ACCC understands that InContact represents only a small proportion of Telstra's customers.[10] Nonetheless, its inclusion may slightly reduce the margin in the imputation test for local calls and line rental services.

2.5.3 Domestic and international long-distance and fixed-to-mobile calls

In the retail supply of domestic and international long-distance and fixed-to-mobile calls, Telstra would make a positive margin if it purchased the essential input, the domestic PSTN originating and terminating access, at arms' length from itself.

Telstra's margins vary significantly between the three retail services, with the highest margins being achieved on domestic long-distance calls, then international long-distance and then fixed-to-mobile calls.

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[8] ACCC, *Final determination for model price terms and conditions for the PSTN, ULLS and LCS services,* October 2003, p. 101.

[9] Telstra proposed access undertakings to the ACCC in respect of the LCS but only for the period ending 30 June 2005. The ACCC has accepted these undertakings. This does not effect the ACCC's intentions to undertake a wider review of the LCS, as outlined in those reports.

[10] InContact is only available to non-business customers, holding an eligible concession card, at private dwellings where no other access service is provided to the dwelling or customer.

The margins also vary between business and residential retail services. Margins on business long-distance calls are higher than residential long-distance calls, but lower on business fixed-to-mobile calls compared with residential fixed-to-mobile calls.

This is the first report to separately identify ongoing ancillary costs of utilising the PSTN core service. The ancillary costs are separately listed in the cost categories and contribute towards unit costs. For PSTN services, the annual switchport charge has been identified as the only ongoing ancillary charge for using PSTN services. This charge comprises less than 3% of costs for domestic long-distance calls and less than 1% of costs for international and fixed-to-mobile calls (for both residential and business customers). It should be noted that as the RAF does not disaggregate costs between customer groups, there are no differences between the unit costs for residential and business customers.

The ACCC also notes that all fixed-to-mobile calls are assumed to be terminated off-net. As the cost of terminating calls is considered less than that currently charged by mobile operators for the mobile terminating access service, to the extent that an access seeker can supply on-net fixed-to-mobile calls, the margins will be understated. This qualification is also relevant to the bundles that include fixed-to-mobile calls.

2.5.4 Bundle of fixed voice services

Imputation tests have also been undertaken on bundles of fixed voice services, comprising of local calls, line rental, domestic and international long-distance calls and fixed-to-mobile calls. Telstra passed the test for the bundles with a margin of 11% for residential customers and 5% for business customers.

2.5.5 ADSL

Imputation tests has been conducted on services that use the ULLS as a core service input. The results indicate that in the retail supply of ADSL, Telstra would make a significantly negative margin if it purchased the essential input, the ULLS, at arms' length from itself.

Table 2.7 indicates that a margin of –224% would be incurred in supplying the ADSL service to residential customers, and –180% to business customers.

The main reason for the significant fail margins is the cost incurred in supplying ADSL that is additional to the purchase of the ULLS core service. Table 2.2 shows that an access seeker supplying an ADSL service to a business customer would per month, on average, receive $55 of revenue, pay $24 for the ULLS and incur $131 of costs in transforming the ULLS service into the retail ADSL service. TEBA charges account for approximately $5 of the monthly costs.

In assessing the cost aspects of the reported results, the following factors should be considered:

- The imputation test uses the average total cost of transforming the ULLS into ADSL, which assumes that ADSL over the ULLS would make a pre-determined contribution to an access seekers common costs.[11] Telstra has indicated to the ACCC that access seekers would be unlikely to make such a contribution to overheads and common costs given that ADSL has not reached sufficient maturity. The ACCC notes that the maturity of the market, or otherwise, is debatable given that ADSL has been offered since August 2000 and that over 1.5 million customers now acquire broadband services, of which over 1 million are ADSL services.[12]

- A further aspect of this is the extent to which Telstra's product and overhead costs are an accurate representation of those costs faced by access seekers who are targeting niche areas and customers, particularly in the business/corporate segment.

- The method for calculating TEBA charges assumes a mature level of utilisation of the ULLS, estimated at 66% of tie copper pairs that have been installed in Telstra's exchanges. Therefore, the results will understate the TEBA charges per ULLS customer supplied until the access seekers reaches the nominated mature level of utilisation. Some elements of these charges may however be captured in the RAF cost categories, leading to some double counting.

- The test excludes costs associated with the installation, removal or connection of equipment in relation to customer premise equipment. If access seekers subsidise these costs to acquire customers, the actual margins would be less (i.e. more negative) than those reported.

In considering the difference in results between customer groups, the following factors should also be considered:

- The customer groups are currently determined on the basis of unaudited survey data collected by Telstra when the ADSL service is first connected to the customer.[13]

- The revenues for BigPond services are averaged across customer groups rather than allocated directly to each. If one class of customers generally subscribes to higher priced BigPond plans, the reported results would understate the revenues earned from that customer group and overstate the revenues received from the other customer group.

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[11] It should be noted that the ACCC assessment of the price squeeze allegations regarding the pricing of wholesale ADSL did not use RAF information, although the RAF has been used as a limited cross-check for other information provided.

[12] ACCC, *1.5 million broadband services connected: ACCC,* media release, 10 March 2005.

[13] The ACCC has concerns about the robustness of this approach and Telstra has undertaken to implement system changes to enable allocation of customers on the basis of the line rental charged on the underlying line rental service. These changes should be implemented in time for the June quarter 2005 report.

- As the RAF does not disaggregate costs between customer groups, the costs are averaged over each customer group's demand for the service.

The ACCC notes that the test focuses on the use of ULLS to supply ADSL, but other wholesale inputs may used, including wholesale ADSL services. Additionally, use of the ULLS core service enables other retail services to be supplied in conjunction with ADSL. The provision of other services, such as SHDSL, may yield significantly higher revenues per quarter than ADSL services.

Notwithstanding the qualifications above (which could mean that actual margins are either more or less than those reported under the current imputation test) the results appear to strongly indicate that any business model involving the use of ULLS to supply only ADSL to customers is likely to be flawed. The tests involving a combination of ADSL and voice services may therefore more accurately reflect current market conditions.

2.5.6 Bundles of ADSL and fixed voice services

Imputation tests have been undertaken on bundles of ADSL and fixed voice services, (comprising of local calls, line rental, domestic and international long-distance calls and fixed-to-mobile calls). Telstra fails the tests for both residential and business customers.

The test on the bundle for residential customers, which consists of one ADSL service and one voice service, fails with a margin of -93 per cent. The test on the bundle for business customers services, comprising one ADSL service and four voice services, fails with a margin of -13 per cent.

The factors outlined in section 2.5.5 and the qualification regarding fixed-to-mobile calls in section 2.5.3 are also relevant for these tests.

In addition, the imputation test assumes that the costs of supply of the voice services in this bundle would be in line with costs of supply of voice services over the PSTN. Service providers wishing to supply voice services and broadband services over the PSTN could choose to do so voice over broadband/data/IP alternatives—this may result in significantly lower costs than those reported in the current tests.

The ACCC again notes that these tests focus on the use of ULLS to supply ADSL and voice services, but that other wholesale inputs may used. Additionally, use of the ULLS core service enables a wide range of retail services, not limited to just ADSL and the aforementioned voice services, to be supplied.

That said, the results indicate that in the absence of market developments, the use of the ULLS to supply competitive services will likely be limited to areas in which costs of supply are lower and/or are able to be directed to customers that yield higher revenues per service supplied, as compared to the average revenue and cost estimates used in these tests, such as medium and large business enterprises.

Market developments that could expand the scope of services that could reasonably be expected to be supplied would include the supply of other services over the ULLS (e.g. pay TV, higher speed/quality DSL services, other multi-media services), or reductions in access prices or other cost inputs.

The results of these imputation tests indicate that it is not simply the access price of the ULLS that is likely to be driving the negative results—this is because the costs involved in transforming the ULLS into ADSL are of much higher magnitude than the access price. This may suggest that the ACCC should focus greater attention towards identifying cost and non-cost barriers to use of the ULLS. The ACCC is looking to make variations to its *2003 Model Core Services Terms and Conditions Determination* for the ULLS (and also apply this to the line sharing service (LSS) as appropriate). Updating the model terms and conditions would provide guidance to industry as to what the ACCC generally considers to be reasonable terms of access, and as such would facilitate the negotiation of reasonable terms of access to the ULLS.

Finally, the ACCC notes that Telstra has been critical of the tests using the ULLS. For example, Telstra has argued that the ACCC should model access seekers' costs rather than basing the test on Telstra's costs. However imputation testing is based on Telstra's costs in order to present the margins available on the ULLS for an access seeker as efficient as or more efficient than Telstra. The ACCC regards this as being the fundamental concept behind the imputation testing procedure and will retain the use of Telstra's costs in the test. However, the ACCC intends to consider other possible refinements of the test to ensure it is as accurate and reflective of access seekers' circumstances as possible.

2.6 Reconciling imputation RKR data with the RAF

Telstra prepares its imputation reports each quarter. In doing so, it uses revenue and volume data to obtain the retail price and access price, and uses RAF data to obtain unit costs.

Ideally, the imputation test results would be based on retail price, access price and unit cost figures appropriate to the quarter. Telstra is able to obtain retail price and access price data from its management systems on a quarterly basis. However, the RAF is only published twice a year, and is not available until after the imputation testing results must be submitted to the ACCC. Imputation testing is therefore conducted using cost data from the previous half-year's RAF reports.[14]

The reconciliation report is designed to check whether the use of this lagged data affects the results of the imputation tests, and whether the quarterly reports are presenting a reasonable estimate of the actual imputation margins available in a particular quarter.

Telstra is required to submit a reconciliation report at the same time as the RAF report to which the reconciliation report relates. The RAF for July–December 2004 is

[14] For example, in the results for the June quarter 2004, the unit cost data was obtained from the July to December 2003 RAF. The current report for the September quarter 2004 uses data from the January to June 2004 RAF.

required to be submitted at the end of March. The ACCC will comment on the reconciliation report in the next quarterly report.

2.7 Extent to which the reports comply with the RAF and other RKRs

The Ministerial Direction requires the ACCC to comment on the extent to which the reports comply with:

- the RAF
- any other relevant record-keeping rules made by the ACCC (whether for the purposes of the Minister's Direction or otherwise)
- any Direction given by the ACCC for Telstra to make public information contained in the reports.

This section discusses the extent to which the reports comply with the RAF.

2.7.1 Relationship between the RAF and the imputation RKR

Telstra provides financial information to the ACCC in the RAF. Under the RAF, Telstra must provide capital adjusted profit and loss statements for its retail services, internal wholesale services and external wholesale services. Telstra must also provide capital employed and fixed asset statements for those three services.

The Ministerial Direction requires that Telstra provide the imputation RKR information to the ACCC each quarter. Telstra currently provides RAF information to the ACCC every six months. To address this time disparity, the ACCC requires Telstra to:

- obtain revenue information for core and retail services for the relevant quarter from Telstra's general ledger accounts
- obtain volume information for core and retail services for the relevant quarter from Telstra's management information systems
- obtain cost information for retail services each quarter by multiplying the volume data for the relevant quarter with the unit costs of the service derived from the RAF accounts for the six-month reporting period preceding that quarter.

The RAF records volume information for retail and core services. The imputation RKR requires Telstra to use volume data for retail services from the RAF for the previous six-months to unitise cost information. It also requires that volume data for the relevant quarter be used, which can later be compared to the volume data that appears in the RAF.[15]

The ACCC notes that the RAF does not disaggregate data between business and residential customer groups.

2.7.2 Revenue differences between the imputation RKR and the RAF

The RAF allocates revenues across various retail services. The imputation RKR requires Telstra to allocate its retail revenues in a manner consistent with the RAF. This allows for the reports provided by Telstra to be reconciled with the RAF data in future periods.

The ACCC has noted one relevant difference between the revenues that Telstra extracts from its general ledger for the imputation RKR and those included in the RAF. The definition for the domestic long-distance service in the imputation RKR excludes revenues from operator assisted calls, which are included in the corresponding RAF category. Therefore, the domestic long-distance revenues in the RKR will be lower than the RAF revenue for the national long-distance retail service.

The revenues for line rental, local calls, international long-distance, fixed-to-mobile calls and ADSL in the imputation RKR are consistent with the revenues items for these services in the RAF.

2.7.3 Cost differences between the imputation RKR and the RAF

The RAF allocates common costs as well as direct costs to wholesale and retail services. The costs attributed to retail services in the RAF are appropriate for calculating ‘retail costs’ for the imputation test, but do not include all costs in the transformation of a core service to a retail service (such as transmission). Therefore, the additional costs are listed separately as ‘other costs’ in Telstra’s imputation testing results.

Telstra uses unitised cost information from the RAF reports from the preceding six-monthly reporting period, which is multiplied by the volume for the relevant quarter. This cost information is later reconciled with the RAF. In constructing the imputation test, Telstra raised implementation issues relating to the calculation of appropriate retail and other costs using the RAF data. Telstra and the ACCC agreed on ways to resolve these issues. This has resulted in some adjustments to the RAF figures in the imputation test. The adjustments relate to:

- the removal of installation costs from the cost of line rental and ADSL—as required by the imputation RKR

- the removal of modem costs from the cost of ADSL—implied from the definition of ADSL in the imputation RKR

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15 The ACCC has released some volume information pursuant to section 151BUA of the Act. See, for example, ACCC, *Telecommunications market indicator report 2002-03* (June 2004).

- the use of a mobile termination methodology for costing fixed-to-mobile services
- avoiding the double-counting of ULLS and PSTN originating and terminating access service costs
- adjustment to call costs used in the bundle of ADSL and fixed voice products when services are provided over the ULLS
- ancillary costs.

The latter four dot points are described in more detail below.

The ACCC also notes that Telstra has included the retail and wholesale costs of capital in the imputation tests. The WACC used in calculating the cost of capital is that set out in Telstra's RAF. In its RAF for the six months to June 2004, Telstra used an annual WACC figure of 14.75%. Should Telstra have used the ACCC's WACC, then Telstra's calculated costs would have been lower and, as such, the imputed margins would have been higher.

Mobile termination methodology for fixed-to-mobile services

As the imputation tests are designed to show whether an efficient access seeker is able to compete with Telstra, the imputation test needed adjustment to account for Telstra's on-net fixed-to-mobile calls. The ACCC and Telstra agreed that Telstra impute the weighted average mobile termination charge that would apply to an access seeker which terminates fixed-to-mobile traffic on Telstra's mobile network.

Double-counting ULLS and PSTN originating and terminating costs

To calculate the costs of transforming the PSTN and ULLS core services into the retail services specified in the imputation RKR, Telstra uses its Retail and Internal Wholesale accounts in the RAF. However, the Internal Wholesale accounts include costs of network elements and functions that are already captured in the access prices for the PSTN O/T and ULLS. For example, the Internal Wholesale costs recorded in the RAF allocate local switching and transmission costs to the domestic long-distance service, which are already factored into the PSTN access price.

To overcome this issue, Telstra deducted the common elements located in the External Wholesale accounts (which are used to calculate the access price) from the costs located in the Internal Wholesale accounts in the RAF.

Non-ULLS call costs

For the bundled tests involving ADSL and fixed voice products, the costs for origination and termination for fixed telephony calls change when the underlying service is ULLS.

The ACCC and Telstra have agreed to a methodology that involves several steps. For local and domestic long-distance calls, the PSTN TA network costs are removed from the RAF and PSTN TA charges are added, using a similar method to that used to remove double-counted costs. For international long-distance calls, the international settlement payments are used for termination of such calls. For fixed-to-mobile calls, the methodology explained above for mobile termination is used.

Ancillary charges

The imputation RKR requires Telstra to calculate ancillary charges for the PSTN (consisting of switchport charges) and ULLS (Telstra Exchange Building Access charges). The imputation reports at this stage may double count some of the ancillary charges in the ancillary and cost categories.

2.7.4 Conclusion on the extent to which the reports comply with the RAF

Subject to the exceptions noted in sections 2.7.2 and 2.7.3, the revenue data for retail services and the cost data for retail services is likely to comply with the RAF. Other data involved in the imputation testing is not required to comply with the RAF.

2.8 Accuracy of the imputation RKR reports

The Ministerial Direction requires the ACCC to comment on the accuracy of the reports lodged by Telstra.

2.8.1 Audit process

Clause 13 of the imputation RKR requires a single audit to be undertaken each year. The revised imputation RKR, as issued to Telstra on 29 September 2004, amended the audit requirement such that the auditing period now reflects the financial year.

The audit report covering the September and December quarters 2004, as well as March and June quarters 2005, is required to be provided to the ACCC by 30 November 2005.

2.8.2 Accuracy of report

Given that the December quarter 2004 results have not yet been audited, the ACCC cannot conclusively state whether the reports provided by Telstra for the period comply in all respects with the imputation RKR.

The ACCC also notes that it has identified throughout this report particular factors which should be considered in assessing whether imputation test results prepared under the imputation RKR give an accurate indication of the margins actually available.

3 Non-price terms and conditions report

The key performance indicators (KPIs) on non-price terms and conditions currently relate to Telstra's Basic Access service. They measure the difference between the percentage of Telstra Wholesale customers and Telstra Retail customers (for residential and business customers separately) for which the performance standards are met (defined according to Customer Service Guarantee measures). The KPIs relate to:

- ordering and provisioning
- faults and maintenance
- appointments.

The KPI measures were determined by the ACCC after undertaking a thorough investigation of the systems used by Telstra for the supply of services to its wholesale and retail customers. In particular, the ACCC examined in some detail Telstra's ordering and provisioning systems and its fault rectification systems for wholesale and retail services.

The principal objective of the KPIs is to compare Telstra's performance in providing services to its retail customers to the supply of services to its wholesale customers that on-supply to their retail customers. They are designed to reveal to the public, industry and the Government details of the differences in the treatment by Telstra of its wholesale and retail customers.

The Ministerial Direction requires the ACCC to publish the KPI information provided by Telstra.

Table 3.1 is Telstra's KPI report for the quarter ended 31 December 2004. In this table a positive difference means that Telstra performed better in meeting the performance standard for its wholesale customers than for its retail customers. A negative difference means that it did not perform as well in meeting the performance standard for its wholesale customers as its retail customers.

Table 3.1 Telstra's KPI report for non-price terms and conditions

Ordering and Provisioning – Basic Access

Metric	Measure	The difference between percentage of Wholesale Business customers and Retail Business customers in target (that is, that have met the performance standard)	The difference between percentage of Wholesale Residential customers and Retail Residential customers in target (that is, that have met the performance standard)
1	The percentage of basic access customer installation orders provisioned in the quarter on or by the performance standard – previous service available for automatic connection	1.42	-1.97
2	The percentage of basic access customer installation orders provisioned in the quarter, on or by the performance standard – new service with available cabling and capacity	2.63	-2.72
3	The percentage of Basic Access orders provisioned in the quarter, on or by the performance standard - new service which requires additional cable or network capacity	18.40	10.39
4	The percentage of basic access order appointments that are met in the quarter	-0.55	-0.70

Faults and Maintenance – Basic Access

Metric	Measure	The difference between percentage of Wholesale Business customers and Retail Business customers in target (that is, that have met the performance standard)	The difference between percentage of Wholesale Residential customers and Retail Residential customers in target (that is, that have met the performance standard)
5	The percentage of basic access faults that are rectified in the quarter, on or by the performance standard	0.17	-2.82
6	The percentage of basic access fault appointments that are met in the quarter	-0.31	-0.71

Notes:

- The performance standard used for all metrics is the same as that used for the Customer Service Guarantee, unless otherwise stated.
- A positive difference means that Wholesale met the performance standard in a greater percentage of cases than Retail.
- For metrics 1-3, the performance standard = target provisioning time (TPT)
- For metric 5, the performance standard = target date/time.

Business customers

Telstra's December quarter figures indicate that its performance was generally better for its Wholesale Business customers than for its Retail Business customers. The only exceptions were Metric 4 (the percentage of basic access order appointments that are met in the quarter) and Metric 6 (the percentage of basic access fault appointments that are met in the quarter).

With the exception of Metric 5 (the percentage of basic access faults that are rectified in the quarter, on or by the performance standard) and Metric 6 (the percentage of basic access fault appointments that are met in the quarter), the variances shown in Table 3.2 above indicate that Telstra's performance improved during the December quarter for its Wholesale Business customers compared to the previous quarter.

The greatest variance reported for business customers during the December quarter related to Metric 3 (the percentage of basic access customer installation orders provisioned in the quarter, on or by the performance standard—new service which requires additional cable or network capacity).

While some degree of variance would be expected, the ACCC considers that more significant variances—those of 2 percentage points or greater—require investigation to determine whether a systemic bias may have caused or contributed to the result.

In this regard, Telstra has advised that there were relatively few Wholesale services to be provisioned which required additional cable or network capacity and that as a result the results that it reports for this Metric can be volatile. Telstra also advised that in the December quarter, there were mass service disruptions that affected customers in regions of NSW Country, Queensland Country, Sydney and Victoria Country and that this has contributed to the reported result for Metric 3.

Telstra advised that the results reported in respect of Metric 2—where there was a positive variance of 0.63 percentage points above the materiality threshold—was due to order entry delays during the implementation of its MAXIM system (an integrated platform for major marketing, sales and service applications). As this system is only to be used in supplying Telstra Retail customers, this affected service to Telstra Retail customers only.

Residential customers

Telstra's December quarter figures indicate that performance was better for its Wholesale Residential customers with regard to Metric 3 (the percentage of basic access customer installation orders provisioned in the quarter, on or by the performance standard – new service which requires additional cable or network capacity).

However, Telstra's figures show that its performance was better for its Retail Residential customers for Metric 1 (the percentage of basic access customer installation orders provisioned in the quarter on or by the performance standard—previous service available for automatic connection), Metric 2 (the percentage of basic access customer installation orders provisioned in the quarter on or by the performance standard—new service with available cabling and capacity), Metric 4 (the percentage of basic access order appointments that are met in the quarter), Metric 5 (the percentage of basic access faults that are rectified in the quarter, on or by the performance standard) and Metric 6 (the percentage of basic access fault appointments that are met in the quarter).

The reported results for Metrics 2, 3 and 5 were each greater than two percentage points.

Telstra advised that the Metric 2 result was caused by Telstra system outages that delayed a number of Telstra Wholesale orders. Telstra further advises that it has recently reviewed the stability and performance of these systems and is working on a number of initiatives to improve their reliability. The ACCC intends to monitor this matter in future reports to better ensure that system outages do not become a cause of discrimination against Telstra Wholesale customers.

Telstra's explanation for the reported results for Metric 3 is discussed above.

Telstra advises that the reported result for Metric 5 was affected by a large number of fault reports that were able to be closed without attendance at the customer premises—either by work undertaken at the exchange or because the customer withdrew the fault report. As a greater proportion of such fault reports reported in the quarter were made by Telstra Retail customers, this skewed the results for Metric 5 in favour of Telstra Retail.

Telstra's average annual KPI performance

The ACCC recognises that Telstra's KPI metrics may vary between quarters due to a number of factors. As such, care needs to be taken when making inter-quarter comparisons, as results within a given quarter can be impacted by one-off events. For instance, extreme weather in areas in rural areas—being areas in which there is a relatively high proportion of Telstra Retail customers—can distort the results for a given quarter.

To minimise the effect of these factors and to examine Telstra's KPI performance over a longer timeframe, the ACCC has used Telstra's quarterly reports to calculate the average annual variances in KPI metrics for the 12 months ended 31 December 2004. These results are shown in Table 3.2 below.

In this table a positive difference means that Telstra performed better in meeting the performance standard for its wholesale customers than for its retail customers. A negative difference means that it did not perform as well in meeting the performance standard for its wholesale customers as its retail customers.

Table 3.2 Average variances in KPI metrics - 12 months ending 31 December 2004

Metric	The difference between percentage of Wholesale Business customers and Retail Business customers in target (that is, that have met the performance standard)					The difference between percentage of Wholesale Residential customers and Retail Residential customers in target (that is, that have met the performance standard)				
	2003		**2004**		**Av.**	**2003**		**2004**		**Av.**
	Mar	**Jun**	**Sep**	**Dec**		**Mar**	**Jun**	**Sep**	**Dec**	
1	2.57	1.54	0.76	1.42	**1.57**	-1.28	-1.39	-1.56	-1.97	**-1.55**
2	2.72	1.96	-0.36	2.63	**1.74**	-3.43	-4.82	-1.94	-2.72	**-3.23**
3	5.04	8.21	7.82	18.40	**9.87**	4.10	4.64	8.70	10.39	**6.96**
4	1.31	-1.05	-0.77	-0.55	**-0.27**	1.08	-0.30	0.42	-0.70	**0.13**
5	-1.11	-1.34	0.20	0.17	**-0.52**	-1.12	-1.37	-2.14	-2.82	**-1.86**
6	6.42	1.80	2.19	-0.31	**2.53**	3.02	-0.40	-0.13	-0.71	**0.45**

Notes:

- The performance standard used for all metrics is the same as that used for the Customer Service Guarantee, unless otherwise stated.
- A positive difference means that Wholesale met the performance standard in a greater percentage of cases than Retail.
- For metrics 1-3, the performance standard = target provisioning time (TPT)
- For metric 5, the performance standard = target date/time.

Business customers

Telstra's average annual figures also indicate that its performance was generally better for its Wholesale Business customers than for its Retail Business customers. The only exceptions are Metric 5 (the percentage of basic access faults that are rectified in the quarter, on or by the performance standard) and Metric 6 (the percentage of basic access fault appointments that are met in the quarter).

Residential customers

Telstra's average annual figures indicate a 'mixed' result. That is, performance was better for its Wholesale Residential customers for Metric 3 (the percentage of basic access customer installation orders provisioned in the quarter, on or by the performance standard—new service which requires additional cable or network capacity), Metric 4 (the percentage of basic access order appointments that are met in the quarter) and Metric 6 (the percentage of basic access fault appointments that are met in the quarter) and performance was better for its Retail Residential customers for Metric 1 (the percentage of basic access customer installation orders provisioned in the quarter on or by the performance standard—previous service available for automatic connection), Metric 2 (the percentage of basic access customer installation orders provisioned in the quarter on or by the performance standard—new service with available cabling and capacity) and Metric 5 (the percentage of basic access faults that are rectified in the quarter, on or by the performance standard).

That said, most of the annual variances were of less than two percentage points, and as such would not suggest that systemic discrimination has been occurring.

In respect of the reported results for Metric 2 for residential customers, however, Telstra's reports show that on an annual basis Telstra's performance has been better for Telstra Retail by more than two percentage points.

As noted above, the ACCC has raised this matter with Telstra and has been advised that Telstra is working to address system issues that have contributed to its performance in respect of this metric. The ACCC intends to monitor this matter in particular for future reports.

While the above information provides no evidence to suggest that there is any systematic discrimination against Telstra Wholesale customers, it may not be possible to identify given the highly aggregated information used in the reported Metrics. In addition, it does not provide a means of identifying or addressing individual cases of discrimination. The ACCC will, therefore, continue to monitor any trends in performance and respond to complaints of discrimination on their merits.

3.1 Extent to which the report conforms with the RKR

The ACCC is satisfied that the December 2004 quarter report conforms with the requirements of the RKR.

The non-price terms and conditions RKR requires Telstra to aggregate end-user customers into the business customer group and the residential customer group on the basis of Telstra's product codes. This is the basis on which Telstra bills its customers.

In order to allow Telstra to implement the necessary changes to its information systems, the ACCC advised Telstra that internal customer codes could be used to group customers for the first two KPI reports.

Telstra advised that it conducted a sample test which indicated that the use of consumer ownership codes appears to offer a reasonable proxy for customer aggregations based on product codes.

Telstra recently advised the ACCC that all of its KPI reports up to and including the September 2004 have been prepared on the basis of customer codes. That said, for the purposes of comparison, Telstra provided two reports for the December 2004 quater. The first report is based on product codes and the second is based on customer codes. A comparison of the results is shown in Table 3.3 below.

Table 3.3 Comparison of December 2004 reports using product and customer codes

Metric	Measure	The difference between percentage of Wholesale Business customers and Retail Business customers in target (that is, that have met the performance standard)		The difference between percentage of Wholesale Residential customers and Retail Residential customers in target (that is, that have met the performance standard)	
		Product codes	**Customer codes**	**Product codes**	**Customer codes**
1	The percentage of basic access customer installation orders provisioned in the quarter on or by the performance standard – previous service available for automatic connection	1.42	1.51	-1.97	-2.01
2	The percentage of basic access customer installation orders provisioned in the quarter, on or by the performance standard – new service with available cabling and capacity	2.63	3.31	-2.72	-2.77
3	The percentage of Basic Access orders provisioned in the quarter, on or by the performance standard - new service which requires additional cable or network capacity	18.40	18.90	10.39	10.56
4	The percentage of basic access order appointments that are met in the quarter	-0.55	-0.67	-0.70	-0.70

Faults and Maintenance – Basic Access

Metric	Measure	The difference between percentage of Wholesale Business customers and Retail Business customers in target (that is, that have met the performance standard)		The difference between percentage of Wholesale Residential customers and Retail Residential customers in target (that is, that have met the performance standard)	
		Product codes	**Customer codes**	**Product codes**	**Customer codes**
5	The percentage of basic access faults that are rectified in the quarter, on or by the performance standard	0.17	-1.15	-2.82	-2.83
6	The percentage of basic access fault appointments that are met in the quarter	-0.31	-0.31	-0.71	-0.72

Notes:

- The performance standard used for all metrics is the same as that used for the Customer Service Guarantee, unless otherwise stated.
- A positive difference means that Wholesale met the performance standard in a greater percentage of cases than Retail.
- For metrics 1-3, the performance standard = target provisioning time (TPT)
- For metric 5, the performance standard = target date/time.

The comparison indicates that there are only minor differences in the reported variances using product versus consumer codes. As such, the ACCC will not require Telstra to resubmit its previous reports on the basis of product codes.

3.2 Accuracy

The ACCC issued its audit terms of reference for the initial reporting period ending 30 September 2003. The audit is designed to determine whether or not the report provided by Telstra has been prepared in accordance with the methodologies outlined in the Regulatory Accounting Procedures Manual (RAPM) to meet the requirements of the non-price terms and conditions RKR.

An audit for all reports submitted in the previous four quarters was provided with the provision of the September 2004 quarterly report.

The independent audit report provided by Ernst & Young states that the four quarterly reports covering the period 1 October 2003 to 30 September 2004 provided by Telstra presents fairly in accordance with the non-price terms and conditions RKR and the reporting rules outlined in the audit terms of reference.

A further qualification that needs to be made is that the reported results for all Metrics are not directly comparable to those reported by the Australian Communications Authority in the context of CSG reporting, as the CSG only applies to customers with five lines or less.

3.3 Subsequent reporting requirements

In September 2004, the ACCC issued a replacement RKR in respect to the provision of information on KPIs on non-price terms and conditions. The replacement RKR includes additional KPI measures for ADSL services (ie. metrics for activation, service restoration and service qualification) and recurring faults metrics for both business and residential customers of Telstra Wholesale and Telstra Retail.

The ADSL measures will come into operation progressively from 1 January 2005 with initial reporting for the 1 April to 30 June 2005 period. One implementation issue is the period that should be specified for the provisioning of ADSL orders. The period specified is 5 days for standard connections and 20 days for held orders. The ACCC would envisage that these time periods will require further attention especially as ADSL services mature—the rules envisage that time periods can be progressively altered (eg. where market outcomes are out of line with targets).

As noted in previous reports, the ACCC intends to adopt a phased approach to the development of KPIs. The ACCC, therefore, will continue to discuss with Telstra, and industry more generally, a number of possible options to improve the KPIs in order to meet the Government's stated policy objectives.